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SIPDIS

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SENSITIVE

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SUBJECT: TURKEY'S LIBERALIZATION WOES: SMOKE, BUT NO FIRE

REF: A. ANKARA 3223

[B](#). ANKARA 3258

[C](#). ANKARA 2812

[D](#). ANKARA 3845

Sensitive But Unclassified. Please handle accordingly.

[1](#)1. (SBU) Summary: Despite a modest but tangible political will to privatize, and efforts by the Privatization Administration, Competition Authority, and other sectoral regulatory bodies, Turkey's program of sectoral reform, liberalization, and privatization remains delayed and troubled. Across several key sectors, particularly energy, aviation and telecom, delay in liberalization and privatization appears to indicate a lack of political will to relinquish state control. Reftels have provided background on impediments to privatization: deep opposition from the judiciary, unions, and the "deep state", particularly if it involves relinquishing control to foreigners. Liberalization remains flawed or unsteady, given lack of regulatory transparency and/or weak and embattled regulatory agencies, in the face of entrenched government bureaucracy or dominant state companies. End Summary.

They Might be Privatizers, but they ain't Liberalizers

[1](#)2. (SBU) Turkey has made significant progress in rebounding from the 2001 financial crisis and stabilizing the economy, largely through competent fiscal and monetary policies overseen by the IMF. However, with the IMF limiting itself to broad macro policies and a relatively limited set of structural reforms, the GOT is missing an opportunity to lay the foundations of stronger growth over the long-term by failing to aggressively privatize and, especially, liberalize several key sectors of the economy. Sectors such as aviation, telecoms and energy continue to see a high degree of state intervention with only small steps towards liberalization likely in the medium-term. Many small state enterprises have been privatized, but hardly any large SEES have been. This could change, however, in the coming months if the Turk Telekom, Erdemir and Tupras deals are consummated. While privatizing any of these flagship companies would be a major accomplishment in the Turkish context, the GOT's focus--and the public debate--continues to be on the proceeds of the sale, not on the benefits of moving to a fully-liberalized economy with strong regulatory bodies. Moreover, several significant state enterprises are not slated for privatization at all.

Energy: Need for Capital, but Fear of Foreigners

[1](#)3. (SBU) The Energy Regulatory and Market Authority (EMRA) has been engaged in bitter turf battles with the Energy Ministry and other parts of the bureaucracy, as it attempts to regulate and foster a competitive market in electricity, natural gas, and petroleum sectors. EMRA reps have told Embassy they fear prospective legislation, which they say, would limit its independence. Working with the World Bank, Turkey has put in place an Electricity Strategy Paper, which identifies the need for foreign capital to increase power generation capacity to fill a projected shortfall of supply over demand. The Privatization Administration (PA) has targeted electricity regional distribution for privatization first. U.S. firm AES is persevering in its interest in this potential tender, but there have been delays and uncertainty in finalizing privatization method, timing, and legislative underpinning (Ref A). The GOT's love-hate relationship and steps forward and back on Transfer of Operating Rights (TORs) and other past models for encouraging foreign investment in generation has created historical baggage and impediments to privatization and liberalization.

[1](#)4. (SBU) State pipeline company BOTAS has not been targeted for privatization, on the implicit grounds of need to

protect the national champion to compete and negotiate with the likes of Russia state pipeline monopoly Gazprom. In accordance with the Natural Gas Strategy Paper, the GOT is proceeding with tenders for new municipal natural gas distribution networks. This is generally perceived as successful, but some observers worry about inadequate prequalification criteria. The targeted transfer of BOTAS natural gas import contracts has been postponed at least four times. A BP contact told us that the legislative underpinning and process were still unclear, with respect to gaining approval from sellers (Russia and Iran). He fears that a new amendment under consideration would confer excessive control on sellers like Russian Gazprom and firms partnered with it.

15. (SBU) State oil company TPAO is also not slated for privatization as national champion. As in many other countries, foreign oil companies are required to partner with the domestic state company for exploration. The investment regime for oil and gas exploration and development is generally perceived as not that favorable for foreign firms. There are a few lingering investment disputes. A prospective new petroleum law, which would introduce modest improvements and incentives, has been held up at the parliament. The state refinery TUPRAS is slated for privatization and there is significant interest, but there is significant opposition from the labor union, which was successful in derailing the last tender won by Russian Tatneft and Turkish Zorlu. A labor-sponsored advertising campaign used fear of giving away the national wealth to argue against TUPRAS' prospective privatization (Ref B).

Telecom: Need for Foreign Capital, but Fear of Letting Go
- Two Strikes, and ...

16. (SBU) State firm Turk Telekom is the overwhelmingly dominant presence in the fixed line telephony, although private Turkcell dominates mobile telephony. The July 1 win by Oger Telecom of the bidding process for 55 % stake in Turk Telekom raises hope the deal could finally go through(Ref C) Turk Telekom's privatization has failed two times before, so this is generally viewed as the last chance. This privatization round has faced delays, and will have to overcome entrenched opposition from labor, the judicial system, and - some say - the "deep state" (concerns about foreign control of what is perceived as a strategic asset). The announced sale of a majority stake in mobile company Turkcell to Nordic TeliaSonera has been reneged upon by the Cukurova Group (in favor of a minority interest transaction with Russian Alfa Telecom), and TeliaSonera has taken the case to the courts. Either of these deals being consummated will represent a major new inflow of FDI and a powerful symbol that both the telecom sector and the climate for foreign investment are changing.

17. (SBU) Uncertainty, lack of competition, and expensive/inadequate service in the telecom/internet sectors has contributed to overall weakness in the investment climate. While competition and liberalization exist in principle in some key domains, such as long distance and internet access, in practice Turk Telekom has used its dominant position to stifle competition. Providers in these areas complain about facing a price squeeze between wholesale access to the Turk Telekom network and retail competition with Turk Telekom. The well-intentioned, but relatively weak Telecom Regulatory and Competition Boards have struggled to enforce rulings. Turk Telekom has not allowed remarketing of its sole wide-band (ADSL) service and value-added service such as Voice Over Internet Protocol (VOIP). Consequently, Turk Telekom's dominance is unlikely to be resolved by merely selling a 55% stake, however positive a step this is.

Aviation: Fear of Competition

18. (SBU) Although competition exists on paper, state enterprise Turkish Airlines still controls slots and routes. Turkish Airlines recently exercised this control in squeezing out private upstart Atlas Airlines, which had the audacity to compete vigorously on price with Turkish Airlines on the key Ankara-Istanbul trunk route. Turkish Airlines is on a half-hearted "B-list" for possible privatization, but sale of shares to the public-with continued government control--is the most likely outcome.

Comment

19. (SBU) The state seems loathe to yield control of vast swathes of the economy still firmly in its grip. Long promised to the International Financial Institutions, and

long identified as critical for providing access to needed foreign capital, embracing E.U. accession, and providing better service to its citizens, privatization and, especially, liberalization are hard to do. Despite a government with a clear majority, there has only been a political will for partial privatization, rather than for a more aggressive privatization program coupled with liberalization. Turkey's failure to transfer its large state enterprises to private control is a major weakness of its economic reform program. Turkey faces the risk that it will fritter away chances to move ahead in global linkages and competition, while the value of the state firm dinosaurs will decline. Successes so far by the Privatization Administration have been generally limited to IPO's, which gain revenues trumpeted by the PA, but which do not relinquish state control of these strategic assets. Struggling sectoral regulatory boards fear prospective legislation that would further decrease their independence, vis a vis the government bureaucracy.

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